

**COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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Investigation by the Department of its own	)
motion as to the propriety of the rates and	)
charges set forth in the following tariffs:	)
M.D.T.E. No. 14, filed with the Department )	D.T.E. 98-15
on January 16, 1998 to become effective )	Phase II
February 14, 1998, by New England )	
Telephone and Telegraph Company )	
d/b/a Bell Atlantic- Massachusetts )	
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**REPLY BRIEF OF CTC COMMUNICATIONS CORP. AND  
TELECOMMUNICATIONS RESELLERS ASSOCIATION  
REGARDING RESALE DISCOUNT ISSUES**

**I. INTRODUCTION**

CTC Communications Corp. ("CTC") hereby files its reply brief in accordance with the established procedural schedule. Telecommunications Resellers Association ("TRA")<sup>1</sup>, on behalf of its members, joins with CTC in filing this brief.<sup>2</sup>

**As discussed at length in the initial brief, CTC and TRA strongly urge the Department to adopt as the permanent wholesale discount that proposed by CTC (27.68% where the reseller uses Bell Atlantic-Massachusetts ("BA-MA") operator services), or at the least the approach used by the Department in its order in the *Consolidated Arbitrations*, D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-84, Phase 2**

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<sup>1</sup> TRA is a national industry association representing more than 650 members, including CTC, engaged in the provision of value-added interexchange, local, wireless, Internet and enhanced services. TRA was created, and carries the ongoing mandate to foster and promote the development of competition in telecommunication markets.

<sup>2</sup> This brief responds to and rebuts many arguments made by Bell Atlantic, but to the extent any of BA-MA's assertions are not specifically addressed, no agreement or acquiescence should be inferred on the part of CTC/TRA.

(1996) (hereinafter the "Phase 2 Order") which yields a 24.99% wholesale discount.

**In any event, BA-MA's cost study and methodology, yielding a proposed permanent wholesale discount of only 15.6%, is too flawed to rely on at all, much less for such a significant change in the level of the discount. As discussed at length in the Initial Brief, BA-MA's methodology does not comply with the Telecommunications Act of 1996 (the "Act") because the discount does not reflect all the costs that BA-MA can avoid as a result of resale. Further, BA-MA's proposal is inconsistent with sound principles of economics**

<sup>3</sup> and that proposal will all but eradicate the resale market in Massachusetts. BA-MA's study and proposed changes must be rejected.

While one or the other party can argue about whose presentations reflect a predetermined result, it is clear that the Department's determination of the proper wholesale discount level must take into account the purpose of the Act, *viz*:

**To promote competition and reduce regulation in order to secure lower prices and higher quality services for American Telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.**

Preamble.

Also, the legislative history evinces an intent to "allow small business people to get into different segments of telecommunications." Conference Report (Senate - February 1, 1996) p. 5686. That almost 3 years after the passage of the Telecom Act, only 1.6%

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<sup>3</sup> In the Consolidated Arbitrations, Phase 2 Order, the Department made several proper decisions as a matter of economics and policy. That the Department may have also had an eye on the FCC Local Competition Order ("LCO") and that the Eighth Circuit stayed the LCO in *Iowa Utilities Board v. FCC*, 120 F.3d 753, 796 (8th Cir. 1997), *cert. granted*, 118 S. Ct. 879 (1998), neither detracts from the reasonableness of the Phase 2 Order nor bars its use as precedent. The Department's decisions were independently valid for reasons set forth in the Phase 2 Order and in the briefs and testimonies of CTC and AT&T. Further, as AT&T pointed out by its Initial Brief (p. 9) the Department's Phase 2 Order appears to have rested on bases other than the LCO in several critical respects.

<sup>4</sup> of BA-MA's retail lines have been resold provides empirical evidence of the need for an appropriate discount level and of the small chance of inefficient resellers being supported by an overly generous wholesale discount. Of course, an insufficient discount, like that proposed by BA-MA would undermine the policy goals set by the Telecom Act of 1996 to foster a competitive market.

Further, CTC and TRA do not rely upon the FCC's order, rather they rely on sound economic principles with due consideration of the goal of promoting competition. The record and initial briefs show clearly that BA-MA's proposal will stifle competition. (CTC In. Br. pp. 7-8, 12). Exh. ATT - Phase II-1, p. 17. Additionally, even BA-MA acknowledges that it has a burden of proof with respect to the reasonableness of its proposal and the significant reduction in the wholesale discount level. BA-MA In. Br. p.13. The Department must ensure that BA-MA makes a meaningful and persuasive showing and conforms to the Department's goal to:

...establish rates for resellers that only pay for costs incurred by the ILEC to supply the wholesale services they are using and not the costs incurred by the ILEC to supply retail services with which they are competing,

Phase 2 Order, p. 9.

CTC does not argue that the Department is mandated to employ FCC presumptions. Rather CTC argues that it is BA-MA that proposes a different wholesale discount level and BA must show that its proposal is proper and consistent with the Act, sound economic principles and public policy. BA-MA's proposal wholly fails to satisfy that burden for the reasons set forth herein.

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<sup>4</sup> Exh. IR-CTC-BAMA 4-1.

**BA-MA'S SUGGESTED STANDARD FOR ESTABLISHMENT OF WHOLESALE DISCOUNT LEVELS IS CONTRARY TO THE ACT AND SOUND ECONOMICS**

**A. BA-MA Considers Costs Fixed That It Could and Should Avoid**

BA-MA essentially advocates a short-run avoided costs standard where only the costs of retailing that are immediately reduced upon a given increment of resale will be considered avoidable. It freely admits that resellers will bear BA-MA's retailing costs under its proposal (Exh. BAMA-Phase II-2, p. 12, 1.17), but relies upon the contorted idea that the Act requires such an improper result. BA-MA further asserts that because it considers certain retailing costs as fixed, it need not do anything to reduce such costs, or at least that, if it does reduce such costs, that should be of no benefit to resellers.<sup>5</sup> Obviously, BA-MA's approach is unsound economically, unfounded and contrary to Department policies and the Act.

**B. Only the Intervenor's Determination of Avoided Costs Excludes BA-MA's Retailing Costs**

BA-MA seeks to convince the Department that the BA-MA standard is the only reasonable standard on the basis that the approach suggested by CTC and ATT is unrealistic. In fact, contrary to BA-MA's assertions, CTC and AT&T use the analytical approach of determining the costs of a "wholesale only" ILEC not to comply with a superceded FCC order, but to obtain an economically pure determination of avoided costs. Exh. CTC-Phase-

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<sup>5</sup> The roommate example is particularly illustrative. CTC's cross-examination evoked an admission by BA-MA that BA-MA's arguments regarding fixed costs are contrary to rational economic action. Specifically, BA-MA testified that, even if roommate Amy moves out (i.e. customers move to resale service), Beth (i.e. BA-MA) would not seek to get a new roommate and would not take other steps to reduce the housing costs. Obviously, a rational economic entity would seek to reduce those costs, in an ILEC's case by downsizing employees and, in the long run, consolidating remaining employees to be able to eliminate facilities and so called "fixed costs". Though BA-MA agrees with the economics (Tr. 4:531), it stubbornly clings onto the assertion that it cannot avoid such costs.

II-1, p. 11, 1.15-17. CTC/TRA In. Br., p. 7. Unlike BA-MA's approach, which brazenly leaves BA-MA's own retailing costs in the wholesale price, the intervenors' approach is based upon the premise that avoided costs are those that the incumbent need not incur to provide wholesale service.<sup>6</sup> Not only is this approach logical, it is consistent with the Department's own reasoning in the Phase 2 Order in the *Consolidated Arbitrations*, (p. 3) and it is even supported by BA-MA's own witness. Specifically, Dr. Taylor offered that the "discount ensures that the reseller does not have to pay for the retail components it does not purchase." Exh. BA-MA-1, p. 3, l. 14.

**C. BA-MA's Approach Does Not Comport With Accepted Meanings of Avoided Costs**

It is also useful to examine legislative analogies to uncover the meaning of avoided costs. One such analogy is the avoided cost framework established by Congress and the Federal Energy Regulatory Commission under the Public Utilities Regulatory Policies Act of 1978 ("PURPA"). In that context, the term "avoided" costs means "the incremental costs to an electric utility of electric energy or capacity or both, which, *but for the purchase from the qualifying facility or qualifying facilities*, such utility would generate itself or purchase from another source." (18 C.F.R. § 292.201(b)(6).) When an ILEC is selling local services at wholesale, it, in essence, is "buying" retailing functions provided by the reseller. Thus, paraphrasing the language of this rule of the Federal Energy Regulatory Commission, "avoided" costs mean, "the incremental costs to an ILEC of retailing functions, which, but for the purchase from the reseller, such ILEC would incur itself or purchase from another source."

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<sup>6</sup> 47 USC § 252(d)(3).

Applying this definition to avoided costs for purposes of determining wholesale discounts under the 1996 Act inescapably leads to the conclusion that all of an ILEC's retail costs must be deemed "avoided" when calculating the discount factor. A reseller's serving a new increment of demand for local exchange service enables the ILEC to avoid all of its retail costs related to serving that increment. This includes all ordering and similar functions carried out by the reseller rather than the ILEC and all advertising and other costs, as well, because the ILEC is not required to advertise or carry out any of these other functions in order to serve the new increment.<sup>7</sup> Instead, all of these functions are being undertaken by the reseller and, under the accepted definition of avoided costs, the reseller is entitled to be compensated for doing so in the form of the wholesale discount mandated by the 1996 Act.<sup>8</sup>

Not too surprisingly, this is precisely the same conclusion reached by AT&T and CTC through their direct application of accepted economic principles. Quite clearly, the use of "avoided" costs correlates directly to the logic of economics and is not intended to simply refer to whatever pricing happens to best suit the ILECs' desires at the time and which "coincidentally" has the effect of dramatically decreasing the wholesale rate in Massachusetts.

Granted, an ILEC may not actually see a reduction in its overall revenue requirement equivalent to the wholesale discount it provides for resold services, particularly in the

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<sup>7</sup> In a related context, the ILEC's wholesale operation acts as a "manufacturer" and "distributor" of telecom services, not as the customer interface or retailer.

<sup>8</sup> Indeed, in a truly competitive market, independent resellers and retailers are regularly used by manufacturers and other wholesalers to carry out retail operations, and they are compensated for doing so because they provide important and valuable functions. The only reason why ILECs oppose use of a competitive pricing model in determining wholesale discounts is because their overwhelming domination of the local market currently makes it unnecessary for them to look beyond their own retail arms to market and distribute their products. They do not need to "win" any customers, and view resellers only as competitors. However, if the market is permitted to develop competitively, ILECs, like their counterparts in other industries, will need to rely on resellers to promote and sell their products.

beginning. However, whether or not it does depends on the extent to which it decides to continue to use its internal retail marketing arm instead of marketing its services through resellers, which is a choice that it alone makes. It should be noted that the very same is true in the electric world under PURPA. If an electric utility chooses to construct generating capacity notwithstanding the availability of power from alternative sources, it will not completely avoid costs either. However, this is simply an accepted outcome of avoided cost pricing.

The concept of avoided cost pricing, if properly carried out and reflecting long run costs, will enable ILECs to be indifferent, from a cost perspective, with respect to whether they furnish retail functions or whether such functions are carried out by resellers. At the same time, it places the resellers at parity with the retail arms of the ILEC.<sup>9</sup> Neither has an advantage over the other in terms of the underlying wholesale costs of the services they sell. The success of each is based on the efficiency at which it carries out retail functions. If the reseller can operate more efficiently than the ILEC, it will profit to the extent that its costs are less than the costs that the ILEC would incur in carrying out the same retail functions; conversely, if the reseller cannot operate as efficiently as the ILEC, it will go out of business.

### **III. BA-MA'S COST STUDY AND DISCOUNT PROPOSAL ARE FATALLY FLAWED AND MUST BE REJECTED**

BA-MA's approach must be rejected for several reasons. First, that approach is methodologically flawed on many counts. Second, it is based on data, the reliability of

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<sup>9</sup> In the context of competitive parity, it is also useful to note the Department's Affiliate Standards Order (D.T.E. 97-96 (1998)) which allows incumbent affiliates no more favorable position than other competitors. BA-MA's imposition of its retailing costs on resellers provides such an undue advantage to BA-MA's retail arm.

which has not been shown for the purpose of determining what costs are avoided. Third, by BA-MA's own admission, BA-MA's approach imposes its own retailing costs upon resellers, contrary to basic economic principles and well-accepted public policy goals. Further, BA-MA asserts that costs are unavoidable in some cases without a shred of evidentiary support and in many cases upon only BA-MA's assertion that they are not avoidable. As shown below, BA-MA has made no reasonable showing to support its proposal and its proposal is not consistent with BA-MA's avowed goal to be indifferent to whether it sells its services at retail or wholesale. *See* Phase 2 Order, p. 12.

**A. BA-MA's Restriction Of Avoided Costs To Those Costs That Vary With Usage Would Provide BA-MA With A Prodigious Competitive Advantage**

The evidence presented by CTC and AT&T, as well as the Department's own findings in the Phase 2 Order, all show that BA-MA's fixed/variable paradigm is wrong and results in an inappropriately low discount. Exh. CTC-Phase II-1, pp. 15-16; Exh. ATT-Phase II-1, pp. 14-20. The reasons are several. First, BA-MA considers costs to be variable only if those costs immediately decrease with each unit of sales shifting from retail to wholesale. The problem with BA-MA's approach is that as those sales shift there is (at least) less usage being made of retail resources, the costs of which BA-MA calls fixed and which BA-MA argues must be borne in the wholesale operations. Exh. CTC-Phase II-1, pp. 15-16; Exh. ATT-Phase II-1, pp. 14-20. Yet BA-MA asserts that it cannot reduce such costs or properly account for the reduction in costs. That is bad economics and unrealistic. As Dr. Kelley observed, as a firm grows or shrinks, overhead costs such as planning or administration (which BA-MA considers fixed) will vary. *Id.* Even if BA-MA had only 30% fewer employees due to the well-accepted avoidance of costs related to retail marketing, billing and collections, BA-MA would ultimately avoid significant "fixed costs" if BA-MA choose



to perform as an efficient producer of wholesale services.<sup>10</sup> In fact, BA-MA's own witness admits that such costs will be avoided in the long run. Tr. 4:409. BA-MA's approach is also fatally flawed because it includes in the price to be paid by resellers costs of items that provide absolutely no benefit to resellers and, in certain cases, are even totally discretionary to BA-MA, for example executive perks, or as noted on the record, the big screen television for BA-MA executives.

However, for purposes of the wholesale discount, BA-MA simplistically treats such costs as fixed and unavoidable. That means that resellers will both pay more than they ought and will support BA-MA's own competitive retailing efforts - a double whammy against resellers. BA-MA's approach directly contradicts the Department's finding expressed in the Phase 2 Order that "while the retail-related costs might not be "avoidable" in one sense of the word, *i.e.* they exist and are fixed or NYNEX as NYNEX today exists, they are certainly avoidable from the point of view of an efficiently operating wholesale company". p.13.

Dr. Ordoover correctly criticizes BA-MA for using a marginal (short run) cost test to determine avoided costs. One significant problem with that approach is that any competitors that have not already incurred their fixed costs will not be able to compete with BA-MA in economic terms. Even Dr. Taylor acknowledges the purpose of the discount is to allow the market to function efficiently by allowing resale by efficient resellers. Exh. BAMA-Phase II-1, p. 5. The wholesale discount should allow for customers to make economic choices between resellers and the incumbent. However, adoption of BA-MA's approach effectively

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<sup>10</sup> Ms. Degnan's reference to removal of a single marketing executive -- a mere \$24,680 -- is wholly inadequate. Exh. BA-MA-Phase II-3, Attachment 2B, p. 7, A/C 6711. Such cost and function avoidance would allow for reduction of administrative support (which is not shown is so small to be meaningless), general assets (office space could be consolidated and sublet easily in the hot Boston market). Many other "fixed" costs, e.g. the full range of overhead costs, are similarly avoidable, and at the least can be scaled down consistent with concepts of corporate efficiency.

means that to compete, new entrants must be super-efficient because not only will their variable retailing costs have to be less than the wholesale discount, but they will have to squeeze "fixed costs" (computer systems, overhead etc.) **and profit** out of that same small discount. One useful perspective on BA-MA's argument here is that it is the same argument advanced by proponents of continued construction and financing of nuclear generating plants. There proponents argued because fixed costs were "sunk", the incremental cost to completion was inevitably less than alternatives. BA-MA asserts the same theory here (e.g. its systems costs are sunk so cannot be used for the wholesale discount which allows comparison shopping). The ultimate effect (intended or not) is to raise barriers for entry of new competitors, and thereby inhibiting the development of new or more efficient processes, and technologies, which a competitive climate fosters.<sup>11</sup>

**B. BA-MA's Use of Function Code Detail Does Not Satisfy Any Reasonable Burden**

BA-MA makes much of the "granularity" of its presentation, but fails to make any convincing presentation how the vast majority of "unavoided" costs really will continue as sales transition from retail to wholesale. This is most telling in BA-MA's "inability" to differentiate retail versus wholesale costs for advertising, product management and corporate expenses. Even for those items where BA-MA has offered some explanation why certain activities associated with a given function code continue in a wholesale context, it has not shown why some costs within those function codes cannot be avoided in the often less costly wholesale context.<sup>12</sup> In fact, BA-MA does not provide any breakdowns between wholesale

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<sup>11</sup> While CTC/TRA recognize the analysis here is not the same as a base rate case, it must be observed that the Department has held marginal cost arguments inappropriate in determining whether utility or non-utility operations should bear a given cost. *Berkshire Gas Co.*, D.P.U. 90-121 (1990), pp. 34 *et seq.*

<sup>12</sup> For example, BA-MA may now require five people to administer retail tariffs and one to administer wholesale tariffs. It would consider five people and attendant costs as unavoidable.

and retail costs in most cases. Yet, at least some of the costs should be deemed avoided. In the less labor intensive wholesale arena, BA-MA will be able to obtain cost reductions with respect to attorneys, accountants, support staff, etc. Simply asserting that a function will be maintained in a wholesale environment and then making the logical leap that the function will require the same resources in a wholesale environment is insufficient to overcome the logic employed by the Department in the Phase 2 Order.

BA-MA's argument that its avoided costs must be correct because it is audited by Coopers & Lybrand is beside the point. Coopers' efforts are primarily for the purpose of verifying expenses, not whether those expenses are properly categorized as either avoided or wholesale related. In fact, the record shows that Coopers' "seal of approval" does not establish reliability of BA-MA's determination of avoided costs. Based on a CTC record request regarding one category, BA-MA acknowledged a mistake affecting seven function codes and provided a revised calculation that yielded a higher wholesale discount. Also, upon further review of BA-MA's functional accounting materials, it appears that other similar mistakes (though of greater magnitude) were made. Exh. BAMA-Phase II-3, Attachment 2A, p. 8, a/c 6721). Specifically, it appears that though BA-MA treated various accounting functions relating to payroll and billing as partly avoided it failed to treat Function Code 11TE in the same manner, although it similarly covers billing and payroll activities and related supervisory activities. *See* IR-ATT-BA-1-3, Tab 12.

Further, BA-MA has not shown that the costs in the various sub-accounts are representative. CTC sought 1995 data (which would have been useful to identify material changes at the sub-account level that were made after the passage of the Act), but it was unavailable to provided a proper baseline for comparison and verification. Exh. IR-CTC-

BA-4-2. While expenses will vary from account to account annually, the volatility here is so great that questions reasonably arise regarding reliance upon such subaccount detail for establishing a wholesale discount. Exh. CTC-Phase II-1, p. 21. The validity of the data at the subaccount level casts grave doubt on its representative nature and reliability in determining the wholesale discount proposed by BA-MA. Again the questions raised about such data are sufficient that BA-MA should not be deemed to have made a showing that it is proper to change the Phase 2 Order discount levels.

**BA-MA Understates The Wholesale Discount By Disregarding Avoidance Of Interstate Costs.**

BA-MA wholly ignores the strong economic arguments advanced by CTC and AT&T for consideration of interstate costs that are avoided through resale. CTC-Phase II-1, p. 19; ATT-Phase II-3, p. 28-29. Basically, BA-MA will reap the windfall of a double collection of such avoided costs unless the wholesale discount reflects such costs also. CTC/TRA Initial Brief, pp. 15-16. As the Department noted in its Phase 2 Order (then not relying on the FCC's Local Competition Order): "Costs will not be avoided based on jurisdiction, but in total. In addition, we agree that to base the avoided cost determination on the separations process would be to impute a policy of shifting avoided costs between jurisdictions, in the manner historically, used to shift local costs to the long distance jurisdiction." Phase 2 Order, p. 33. BA-MA has provided no economic policy reason that refutes the Department's conclusion.

Rather, BA-MA's sole response is the legal argument that a technical statutory construction supports its view. However, it is clear that the Act does not specifically reference the distinction between intrastate costs and interstate costs and the absence of such language should be construed that no such distinction exists. Thus, the statutory intent is not

so clear as BA-MA argues. In that context, Massachusetts law establishes that interpretation of a particular provision must be made consistent with the purpose of the entire statute.

*Rock v. Massachusetts Commission Against Discrimination*, 384 Mass.198, 205 (1981).

There the Court stated:

When the meaning of any particular section or clause of a statute is questioned, it is proper, no doubt, to look into the other parts of the statute; otherwise the different sections of the same statute might be so construed as to be repugnant, and the intention of the legislature might be defeated. And if, upon examination, the general meaning and object of the statute should be found inconsistent with the literal import of any particular clause or section, such clause or section must, if possible, be construed according to the spirit of the act. *Holbrook v. Holbrook*, 1 Pick. 248, 250 (1823). See *Commissioner of Corps. & Taxation v. Dalton*, 304 Mass. 147, 150 (1939).

The United State Supreme Court has also ruled that statutory construction must be in harmony with broad legislative intent. *United States v. Raynor*, 302 U.S. 540, 547; 82 L Ed 413; 58 S. Ct. 353 (1938), *reh den* 303 US 665, 82 L Ed 1123, 58 S Ct 520. Here, as noted in the Introduction of this Reply Brief, it is plain that the Act is intended to promote competition and foster resale markets and that BA-MA's interpretation, which imposes BA-MA's costs upon competitors and thereby acts as a barrier to competition, is contrary to the broad scheme and purpose of the Act. Further, as AT&T points out in its Initial Brief, where retail rates are not cost-based, BA-MA cannot really say that certain costs are in or not in the retail rate. AT&T In. Br., p. 17. All these facts invalidate BA-MA's approach of reducing the wholesale discount by reliance on the artificial separation of the intrastate and interstate jurisdictional costs.

**D. BA-MA's Analysis of Product Management Costs Is Inadequate And Must Be Rejected**

BA-MA's approach for product management costs (Uniform System of Accounts (USOA) 6611) relies on the same flawed concept as discussed above. Specifically, if BA-MA believes that it will still incur a given cost despite sales moving to resellers (because it is "fixed" or will be necessary for wholesale service), it treats such costs as not avoided. However, BA-MA fails to address significant costs that will be avoided. BA-MA's argument that certain activities will be required regardless of mode of delivery (retail or wholesale) (specifically function codes 060A through 0607 and 040A through 0408) is fatally flawed for at least two reasons.

First, BA-MA fails to recognize that resellers will be conducting significant product management efforts of the same nature as the allegedly unavoided costs. Tr. 4:606. This fact leads to the inescapable conclusion that BA-MA can reasonably avoid a significant amount of costs due to the emergence of resellers and resellers performing marketing and product management/development activities. *Id.* Once again, if BA-MA's proposal is accepted, resellers will be paying in the wholesale price the costs of activities that (if BA-MA even continues to do) will be of no value to them because the resellers having the direct customer relationship, must make such efforts. Second, BA-MA's failure to distinguish between costs that are wholesale and retail related results in a significant market distortion with resellers paying for development and enhancement of retail products for which BA-MA does not permit resale. CTC/TRA In. Br., pp. 12-14. Because BA-MA has failed to separate out the truly avoided costs, the Department is essentially faced with choosing a method that clearly leads to an understated wholesale discount -- just as was the case in the Phase 2 Order. This approach is unacceptable in that BA-MA has failed to meet its burden of proof as required by Massachusetts law and Department precedent, so the only alternative

is CTC/TRA's proposal of considering all USOA 6611 costs to be avoided for purposes of establishing the wholesale discount. Note that in the Phase 2 Order the Department reached the same conclusion. Though BA-MA has added a few bells and whistles to its 1996 presentation, fundamentally the current study has the same flaw as the 1996 study, so it must be treated the same. In no way does the Phase 2 Order approach (i.e. treating BA-MA's presentation as inadequate and therefore requiring 100% of such costs be considered avoided) constitute reliance on a rejected FCC presumption. Rather, it is the only alternative where BA-MA has refused to distinguish wholesale and retail costs.

**E. BA-MA's Treatment of Advertising Costs As Fixed And Not Avoided Is Contrary To The Act, Is Anti-Competitive And Is Contrary To Sound Economic Principles.**

**Possibly the most egregious example of BA-MA's efforts to understate the wholesale discount to the detriment of resellers is the approach BA-MA takes concerning advertising costs. Again applying its unrealistic fixed cost approach, BA-MA treats all advertising costs as unavoided. Therefore, resellers bear retailing costs of BA-MA that benefit only BA-MA. BA-MA freely admits this fact, but claims that it is irrelevant to the determination of avoided costs under the Act. BA-MA In. Br. pp.23-24. Notably, BA-MA's sole basis for this legal interpretation is the legal opinion of Dr. Taylor. That, of course, has no legal weight, but like many of BA-MA's argument is unsupported assertion.**

**In contrast, CTC/TRA's position of excluding all advertising costs from the wholesale rate is supported on several levels. CTC/TRA In. Br. pp. 10-12. It is consistent with the purpose of the Act of promoting competition. It is consistent with the economic principle (acknowledged by Dr. Taylor B Tr. 4: 444-445) of**



**avoiding market distortion. Also, where it is BA-MA that seeks to impose such costs on resellers and it is BA-MA that has control of its own financial data and business plans, it is BA-MA that must show convincingly that it will incur advertising costs for purely wholesale purposes. Despite ample opportunity to make such a showing, BA-MA has made no showing at all B just the unsupported and very indefinite assertions of Ms. Degnan that such expenditures would continue.**

BA-MA's attempted defense is entirely unconvincing. It does not even address any of those points. Rather, it recycles its argument that advertising costs are not in retail rates. This argument, of course, was previously rejected by the Department. Phase 2 Order, p. 17. Also, BA-MA's assertion that its continuation of retail functions justifies reseller support of the associated costs becomes more ridiculous with each repetition. Finally, BA-MA's attempt to use Dr. Ordovery's testimony for support is wrong. Dr. Ordovery only agreed that wholesalers **in a competitive wholesale market** would advertise. Tr. 3:333 *et seq.* Also, BA-MA has provided no further information or analysis to require the Department to waiver from the ruling in the Phase 2 Order that:

where carriers are dependent on NYNEX for the underlying facilities that make possible the retail sale of residence and business exchange service, such commercial value is nonexistent. Thus we conclude that NYNEX has not rebutted the presumption that advertising expenses should be considered avoidable for the purposes of determining the wholesale discount (Phase 2 Order, p. 19).

Regardless of whether the Department relied in 1996 on the FCC's presumption, it can now establish its own presumptions. In any event, BA-MA must provide some basis for considering advertising costs 100% not avoided. That it has failed to do.

BA-MA's argument that all retail advertising stimulates wholesale demand adds

nothing to refute the Department's ruling nor supports BA-MA's position that all of its retail advertising costs should be born by resellers because an apportionment is neither feasible nor conceivable. For all these reasons and the reasons set forth in CTC/TRA's Initial Brief, the Department should treat BA-MA's advertising costs as 100% avoided.

**BA-MA's Treatment of Indirect Costs Also Results in a Severe Understatement of the Wholesale Discount.**

BA-MA seeks to justify its treatment of only a small portion of total indirect ("secondary") costs by reference to its supposedly detailed account level analysis, as compared with the intervenors' more general analysis of the ratio of avoided direct to total direct costs. BA-MA's argument is seriously misplaced for at least two reasons. First, the basic premise in this area again is BA-MA's fatally flawed concept that a cost is only avoided if it is variable in the short term in some direct relation to traffic volume. As shown above, such approach seriously understates avoided costs. With such a basis, it does not matter how detailed BA-MA's analysis is **B** the house built upon the sand can only fall.

It is also illuminating that one of BA-MA's "six methods to calculate the level of indirect costs avoided", i.e. method "E" ("Avoided Primary/Total Expense Excluding Depreciation"), is a very similar calculation to that employed by the intervenors. *See* Exh. BAMA-Phase II-3, Att. 2A, p. 14, Att. 3. Note that BA-MA's Method E, contrary to BA-MA's assertions on brief, (p.26) does not "anal[yze] the actual level of avoided costs associated with indirect expenses." Rather, it too assumes a relationship between avoided direct and indirect costs. In fact out of over 300 sub-accounts to which BA-MA employs its avoided methodology, BA-MA uses method E in 165 cases. Excluding the subaccounts that BA-MA claims are unavaoided, BA-MA uses Method E about 95% of

the time. It would seem that either BA-MA's criticism of the intervenors' approach is thereby undercut, or that BA-MA's entire analysis is undercut. Further, BA-MA's "detailed" analysis is a bit of a sham anyway. Of the 300 sub-accounts "reviewed", BA-MA applies method "G" (i.e. "NOT AVOIDED") to 129. *Id.* Thus, less than 15 (or 5%) sub-accounts are really analyzed on the more detailed account by account basis BA-MA touts in its Initial Brief, p. 26 (*i.e.* on a basis other than "E" or "G"), so BA-MA's "detailed analysis" is really more a cover for its characterization of many costs as not avoided. Further, as noted in CTC/TRA's Initial Brief, page 8 *et seq.* BA-MA's process for determination as avoided or not is fundamentally judgmental.

<sup>13</sup> Because of the numerous problems in BA-MA's approach highlighted above as well as the volatility of data provided by BA-MA, there is simply no basis for the Department to accept that approach.

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<sup>13</sup> Even the underlying accounting allocation is judgmental. Tr. 4:509.

#### IV. CONCLUSION

For all the reasons set forth herein, CTC and TRA strongly urge the Department adopt the wholesale discounts as proposed by CTC, namely 27.68% for resellers using BA-MA's operator services.

<sup>14</sup> This is a conservative discount level in that a higher discount is supportable.

<sup>15</sup> The methodology is consistent with sound economic principles and the Department's Phase 2 Order. Alternatively, CTC and TRA, after their review and consideration of BA-MA's argument, believe the Department has sufficient reason to adhere to the Phase II Order and make the interim discount rate permanent. However, any reduction below 25% for resellers using BA-MA's operator services, would be a significant departure from the Phase 2 methodology and would cause a significant reduction in local competition to the detriment of Massachusetts consumers. Also, independent of the policy determination of the discount level sufficient to stimulate a competitive environment, any reduction in the discount level will result in resellers paying costs that support BA-MA's retail efforts and will in effect undermine competition, the fruits of which resale brings to the consumer. All parties seem to agree that such a result would be an improper distortion

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<sup>14</sup> The wholesale discount for resellers providing their own operator services can be calculated therefrom.

<sup>15</sup> Dr. Kelley has identified other cost categories which would have the effect of increasing the wholesale discount, as he indicated in his corrected testimony.

of the market. In any event, the Department must reject BA-MA's proposed resale discount as unsupported by record evidence or sound economic principles or public policy.

Respectfully submitted,  
CTC COMMUNICATIONS CORP.  
TELECOMMUNICATIONS  
RESELLERS ASSOCIATION  
Each by its Counsel

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	)	
<b>Investigation by the Department of its own</b>	)	
<b>motion as to the propriety of the rates and</b>	)	
<b>charges set forth in the following tariffs:</b>	)	
<b>M.D.T.E. No. 14, filed with the Department</b>	)	<b>D.T.E. 98-15</b>
<b>on January 16, 1998 to become effective</b>	)	<b>Phase II</b>
<b>February 14, 1998, by New England</b>	)	
<b>Telephone and Telegraph Company</b>	)	
<b>d/b/a Bell Atlantic- Massachusetts</b>	)	
	)	

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